

POLITICAL IMPLICATIONS OF CORRUPTION: BULGARIA BEFORE 1998

Dr. Krassen Stanchev,
Institute for Market Economics

Introduction

Corruption in Bulgaria has become an issue of public concern on relatively late stage of transition, in 1996 - 1997. Then it coincided with inefficiency and anti-market reform policies of socialist government¹ that brought about hyperinflation and steep decline in production and incomes. Voters penalized the socialist, supporting a reform-committed coalition, which still leads the country towards its integration with the global market, EU and NATO. The mandate of this pro-reform government expires in 2001. Meanwhile, corruption persisted in the years after 1997. Thus, it become obvious that corruption has no political color. This fact suggests that in Bulgaria corruption is rather systemic phenomenon. It necessitated a major government reshuffling in late 1999 (though excused by different reasoning). In 2000, it contributes to a deep government credibility crisis, which might damage reformers' election prospects, threaten economic reforms and roll back the country into mid-90.

Background: Trust² in Bulgarian transition

Due to purely political factors, Bulgarian COMECON-trade in the second half of 1970's and 1980's averaged around 60% of the total. Closest to Bulgaria was Czechoslovakia, with 51-52%, Romania had a less than 30% COMECON-share, while Hungary and Poland were always between 40% and 50%.³ Bulgaria has had an intermediary position between East and the West, importing cheap raw material and resources from Former Soviet Union (FSU) and selling them it recycled to international markets, trying to import back to the East embargoed hi-tech products.

Bulgaria's initial condition has had its long-term institutional impacts:

- 1) Economic structure (in 1989: 59.4% industry, 29.7% services, 12.9% agriculture⁴) although similar to those of other Eastern block countries (e.g. to that of Czechoslovakia) was more artificial and less competitive, dependent 90% on FSU energy supply, based on energy-wasting technologies and lower value added;
- 2) Bulgaria, in fact, had a rent-seeking position between Eastern and Western markets, borrowing from private Western banks to finance transfers of hi-tech to the East;
- 3) The institutional and social stratum to channel these was the branch of State Security Committee (SSC) dealing with the so-called technological intelligence.

The *modus operandi* was the following. Bulgarian government establishes small companies abroad managed by educated SSC-officers and engineers; they sell energy resources and recycled raw materials (bought at subsidized COMECON prices) on international market and buy COCOM-listed products in order to sell them back in COMECON. The operation started

¹ For the brief outline of the last ten years political development in Bulgaria, see Attachment 1.

² It is likely that all CEE countries represent a mixture of different sources of trust: 1) "family-based" trust is mediating barter transactions in subsistence activities, in household of craftsmanship based economies or sectors; 2) "group" trust is based on loyalty-links within or outside single profession, encompassing variety of societal segments (e.g. businesses, political establishments, etc.); and 3) "formalized" (or "impersonal") trust which is based on unified, anonymous, and publicly available information on provisional contractual parties (i.e. information as it exists in company and property registries, credit ratings, stock exchange prospects, etc.).

³ Rumen Dobrinski, *Transition Failures: Anatomy of the Bulgarian Crisis*, Vienna, WIIW, 1997, p.7.

⁴ Source: Bulgarian National Bank (BNB) Annual Report 1991, p. 17.

as an implementation of a confidential decision of the Central Committee of the Bulgaria Communist Party in 1984. It sanctioned the development of small and medium size enterprise, the establishment of their association, Bulgarian Industrial and Economic Association (currently Bulgarian Industrial Association, or BIA), and a creation of special credit line to support “economic initiatives”⁵. Between 1984 and 1986, Bulgaria’s monopoly in information and computing technology on COMECON market was secured for a period of at least five years. The government of Bulgaria or companies themselves was borrowing under government guarantee from the London Club members; fellow eastern intelligence services were backing the technology transfers and securing the smoothness of the operation. The two COMECON bank institutions (International Economic Bank - IEB, and International Bank for Economic Cooperation, or IBEC) and Bulgarian Foreign Trade Bank (currently Bulbank) were executing international payments and transfers.⁶ The precise number of these companies is not exactly known. Nominally, in 1990 they were 96. But the very nature of their business required operation via subsidiaries. After the political changes of 1989 and 1990, they were often establishing joint ventures; managers either decapitalized or privatized them. People around those companies constituted a significant layer of influence in Bulgarian society and politics immediately after the changes and during the transition. They constituted a majority of then slim group of Bulgarian citizens who had the privilege to work in Western conditions and to acquire relevant knowledge. They had also the expertise of transferring funds through company networks in order to loose the track record and dilute the responsibility.

Ironically, those who were thought and who believed that capitalism is about grabbing from others, and were equally convinced by their own experience that there is no other historic option than to restore capitalist economy, were the ones first to become Bulgarian *nouveaux riches*. And they set for capitalism, as they understood it. The group trust among them was higher and more powerful than any other source of trust in Bulgaria. The group had the opportunity to maximize its utility capitalizing the knowledge and the networks. It has established first private banks, got access to government quotas and privilege transactions, was successful in setting first relatively large private business entities in the country and played a key role in financing political parties and individual members of the parliament.

Test Cases: Public Procurement, Concessions, Privatization

Above-described constellation necessitated an approach to the regulatory reform, which, with the idea to retain central government control over the economy, was either delaying implementation of certain norms of transparency, or was sustaining (and in some sectors even increased) high degree of government discretion. The legal framework remained intentionally unclear, thus giving a chance for lesser accountability.

1) There were no general rules of procuring government exclusive right, offers and services for the most of transition years. The first Bulgaria law of public procurement was adopted in

⁵ Later, in 1987 this credit line was separated into a specialized bank, “supporting economic initiatives”, Mineralbank (under central bank receivership since May 1996).

⁶ The time of the creation of these companies coincided with the peak of the accumulation of Bulgaria’s foreign debt. Its structure was 80% to private lenders and 20% to official lenders. (For the sake of comparison, Poland’s foreign debt was 80% to the Paris club and 20 to the London Club). London Club Debt Restructuring Plan of 1994 did not touch the Paris Club share, debts of Mineral bank to foreign institutions, and also mutual obligations between the government of Bulgaria (respectively, Bulbank) and ex-COMECON (respectively, IEB and IBEC). Facing the disappearance of the COMECON market, the last communist government of Bulgaria unilaterally announced a moratorium on its foreign debt payments, in March 1990. In 1991 - the first reform year - the Bulgarian foreign debt amounted to 150% of GDP and 271% of the exports (Source: *BNB Annual Report* 1991, p. 30).

January 1997, seven years after the beginning of transition. It remained without implementation until June 1999 when the second public procurement act was passed. The new act provided stricter procedures and much clearer division of duties of state bodies. However, the regulation has several key lacks: there is no definition of “public procurement”; non-profit organizations are not subject to regulation; public access to procurement registry is restricted and there is an after-auction confidentiality of offers and decision to grant a contract.

2) For a long time there was no general procedure on granting concessions on exploration and use of natural resources, building and maintaining infrastructure, etc. First concession law, requiring unified auction procedures for all concession granting cases, was adopted in November 1996, by then Socialist dominated legislature. But it remains without implementation until the adoption of a second act (originally adopted in September 1997), its amendments (in early 1998) and its implementation rules⁷ in mid-1998. The new act, however, limits requirements for auction and other transparent procedures.

3) Privatization law (adopted in April 1992) allows for a wide degree of discretion in the selection of potential buyers. Privatization can be carried out through different procedures: tenders, direct negotiations, and public offerings of shares, auctions. Privatizing bodies decide on a case-by-case basis which sale procedure to apply. Direct negotiation is the least regulated but, yet, it is the most frequently used procedure⁸. The privatization law introduced a special regime for management-employee buy-outs (MEBO). They enjoy a preferential payment system: MEBO's down payment is 10% of the price, whilst the 90% is paid by installments over a period of ten years. Between 1993 and 1998, 44.3% companies went to MEBO's. In 1998 only, the percentage is 73.4%.⁹ In 1999, MEBO's “won” almost half of all privatization deals. Under the current, believed as center-right and reform-minded, cabinet, the recourse to this preferential system is predicated on the grounds of accelerating the divesting of state's assets. In fact, at least in 1998, “privatization”-to-MEBO's was an explicit attempt to redistributed the right to sell ex-state-owned assets to managers appointed by the cabinet itself, thus allowing them to re-sell.

Institutional Reform Failures

It seems as if in the beginning of the 1990's the key principle of institutional reforms was: no regulation when using other people's and tax-payers' money but over-regulation when people use their own properties and saving. The actual implementation of this is visible, on one hand, in the rules of the banking sector and in the manner to run state owned enterprises, and on the other in entry barriers (licensing, permit procedures and other requirements) for the private sector.

⁷ Bulgarian legal tradition is based on issuance of such rules by the Council of Ministers.

⁸ According to available data, in fact, the percentage of auctions against the total number of deals contracted by both the Privatization Agency and line ministries in 1998 amounts to a mere 6%. It may be interesting to contrast this figure with those concerning the application of ‘open’ privatization procedures Hungary, where they account for nearly 70% of all the deals. See, *Maria Dezserine*, *Accessibility and Transparency of the Public Procurement Process in Hungary, Albania and the Slovak Republic*, Budapest, FME, 1998. In Bulgaria, there is a regularity that for bigger enterprise, the auctions are more frequently used in privatization procedure, but not more than 20% of the sales through the Privatization Agency, while “selection of a strategic buyer” tend to prevail in smaller deals conducted by line-ministries and principals. For details, see: *Luisa Perrotti, Krassen Stanchev*, *The Role of the Core Executive in the Privatization Process: Country Report on Bulgaria* (unpublished report for the OECD/SIGMA and the World Bank, March 1999).

⁹ Privatization Agency, *Privatization Strategy and Program*, no date (1999), p. 1.

Banks and Creditor Rights Before 1997

Capitalization of the private sector was easy in the area of financial and banking services and hampered by administrative barriers in the non-financial sector. Establishment of private banks began in 1990, and was active until 1993: banks emerged in low capital requirements and close to no-barrier entry regime.¹⁰

Bankruptcy regulations were adopted only in 1994 but remained virtually not applied to loss-making SOE's until late 1998. Creditor rights have been protected on paper but difficult to enforce for political and institutional reasons. In 1995, the ministry of industry, being a principal of then still state owned "holly cows" of the Bulgarian industry banned its enterprises of paying debts to the banking sector. Foreclosure procedure by law may take 19 months, a term which high inflationary environment made little sense. Banks "decided" to distribute credits to inner circles believed them being under informal control and develop their own or use available informal enforcement "services". Delayed privatization, lack of financial discipline and widespread possibilities for SOE's to use soft credits, combined with poor lending practices and attempts by the BNB to "cure" the situation with "measured" issues of notes, gradually led to the decapitalization of banks and transfers of the costs to the general public.¹¹ The net losses of the banking sector in 1993 amounted to BGL 5 billion, in 1994 it hit nearly BGL 7 billion; the problems were aggravated in 1995, when the net loss increased to BGL 30 billion by mid-year and about BGL 100 billion by the year's end. In 1996, nine of the ten state-owned banks, which held 80% of banking sector assets, reported negative capital. Direct fiscal transfer costs for resolving the banking crisis of 1996-1997 amounted to 14% of GDP.¹²

1997 and 1999 OECD Economic Surveys of Bulgaria identified two major functions of the above-described institutional design of the banking system, both inductive to corruption. It has been found that, first, "Bulgarian government used commercial banks for the administration of an implicit subsidies as soft credits to loss-making state-owned enterprises." On the other hand, "with access to soft financing, the managers of (undercapitalized) commercial banks themselves actively expanded credit, primarily to the new private sector and often in the context of corruption".¹³ Thus, corruption has been recognized by OECD as one of the key reasons for this situation but it also found that a very large share of bad credits was concentrated in a small number of large loans (each over USD 1.4 million) to private firms which total volume was around 10% of GDP. OECD found also that "Bulgaria was unique in maintaining a relatively high ratio of credit to the non-financial sector in GDP that was comprised of new (post-transition) loans".¹⁴

Presumably, there was no problem to identify beneficiaries of this peculiar system. Bulgarians have a common name for these people: "credit millionaires". At the same time, it is obvious that there was a tacit consensus to bankrupt banks, not the debtors or the loss-making enterprises. The government was satisfied by possibility to procrastinate liquidation of "socially sensitive" enterprise, still appointing political friends and senior public servants

¹⁰ There was no requirement to justify origins of founding capital, most private banks started with borrowed funds. The number of private banks increased significantly (from 2 in 1990¹⁰ to 70 in 1993, consolidated to 26 in 1995); their share in total bank assets was 3.1% in 1992, 22.4% in 1995, and 19 % in 1999 - mostly newly privatised banks, after the closure of 18 banks in 1996-1997.

¹¹ A detailed description of the money transfer mechanism may be found in *Roumen Avramov, Kamen Guenov, Rebirth of Capitalism in Bulgaria*, Sofia, AECD, 1995.

¹² See: *Caprio, Gerard, and Daniela Klingebiel*, "Bank Insolvencies: Cross-Country Experience," The World Bank (unpublished), Washington, 1996.

¹³ 1999 OECD Economic Surveys: Bulgaria, p. 59.

¹⁴ *Ibid.*, p. 102, 103.

to manage them. Workers did not object to keep jobs. Private banks managers and shareholders were happy to receive access to wealth and influence. Companies close to these circles, serving as suppliers and marketers of the public sector enterprises, privatized the profits while the debts were assumed as public debt (and were devalued via high inflation in 1994, and especially 1996 and 1997).

Contract “Enforcement”

The weak government role in securing property and creditors’ right, its resignation from monopoly on coercion in this field, has opened a gap in the public order, which was filled by private organizations. Bulgarians call them “wrestlers”, a general name for racketeers and protection sellers. The name comes from Bulgaria’s 1970’s-1980’s good performance in sports like wrestling and weightlifting. The communist-era ministries of interior and defense managed the best clubs. Sportsmen had army and police ranks and often constituted a pool of future employees of these ministries. When government sport subsidies disappeared in 1990, there was a vast supply ex-sportsmen. They were prompt to set (or refresh) friendships with other servicemen and fill the niches in contract enforcement left by withdrawing government agencies. They establish companies which original area of activity was protection of personal and property security. Rather sooner than later, they have arrived to a broad interpretation of the term “personal and property security”. Besides guarding offices, warehouses and persons, their major services (though not explained in these terms) included also: “motivating” parties to “accept” contractual terms imposed by an initiating party, “monitoring” fellow-circles loyalty, “convincing” those who failed to meet terms of a contract to do so. In order to increase demand for their services, they had to induce violence in the society, create a supportive subculture, and “invent” relevant industries like gambling, prostitution, etc. The security services remained unregulated until April 1994 when the first ordinance (Ordinance 14 of March 25, 1994) of the minister of interior was issued to introduce some rules in this field. In response to the regulation most of the protection reregistered as insurance companies or advertised themselves as investment companies.¹⁵ An IME 1996 survey on private sector transaction costs found that 35% of private firms in big cities of the country have an informal protection contract.¹⁶ There was hardly any small private bank without a board member of sportsman background, and almost for sure there were only few banks that did not resorted to services of such companies. Implementation of 1997 Insurance Law (in 1998 and 1999) permit requirement allowed the Insurance Supervision to refuse licensing of most such companies.

Emerging Private Sector

In a contrast to these lacks of (or delayed) regulations on public procurement, state enterprise management, concessions, banking, creditors rights, and insurance, emerging private sectors was subject to numerous entry barriers. There is strong evidence that fixed capital of small private firms is mainly financed by personal and family sources. Meanwhile, the process of obtaining government “license” and “permit” or other document in order to start and operate a business in the non-financial sector has been originally difficult because of old communist-era regulations and attitudes and was constantly becoming more and more difficult, due to

¹⁵ As is the case of banking, insurance industry enjoyed a long period of free entry; it remained without any specific regulation until April 1998, when 1997 Insurance Act was implemented. Meanwhile, “wrestlers” insurance companies were combining car-insurance with car-theft, house insurance with robbery, etc. In March 1999, the Ordinance 14 of 1994 was replaced by a new regulation - Ordinance I-39 of the minister of interior. It gave a more detailed list of licensing requirements, the key innovation being a crosschecking with tax authorities of the fiscal transparency of the license seeking company and its managers.

¹⁶ See: Barriers to Free Enterprise, *IME Newsletter*, vol. 3, No 7-8, 1996.

new regulations. The table below shows the increase of the number of permits in the transition years.

Government permits to operate a business (as explicitly requested by laws)

Year	Newly enforced permits	Number of permits in place
1989	2	2
1990	4	6
1991	3	9
1992	1	10
1993	5	15
1994	6	21
1995	21	42
1996	13	55
1997	10	65
1998	21	86
1999	20	106

Source: IME¹⁷

The two most significant increases in the number of permits (in 1995 and 1997-1998) coincide with both radical changes in the government: from centrist technocrats to socialist in 1994, and from socialist to democrats in 1997.

Since 1997, the government has abandoned discretionary policies that affect the macroeconomic environment. However, it expands its role in direct regulation of business activities through increased scope of licensing or at least registration requirements. The table does not count regulations dealing with direct government interference in economic affairs, e.g. the Price Act of September 1995¹⁸, or Decree 269 of 1997 On the Methods to Contract Prices on Key Consumer Products¹⁹ - both regulations have been discontinued in 1998. Oftentimes, the need for more permits is explained by EU accession, but deliberate motivation behind these explanations is the desire to have government official in-between transactions. Such motivation was obvious in the Price Act and Decree 269; it is present in some recently adopted acts (e.g. International Road Transport Act - enforced on January 1, 2000 - provides that ministry of transport should regulate tariffs and number of carriers “in times of crisis”). There is little research to what extent harmonization of the laws with EU would create more sources of corruption. However, given the level of administrative competence and the lack of tradition in Weberian bureaucracy it is likely that the new regulation will be adopted at highest possible costs for businesses to comply and at the least transparent procedures.

¹⁷ *In Search for Growth: Policies and Lessons from Bulgarian Economic Reforms*, IME Newsletter, vol. 5, No 11-12. A more detailed picture can be found in: *Administrative Barriers to Investment in Bulgaria*, FIAS, February, 2000; see also: *Licensing Requirements in Retail and Wholesale Trade and Commercial Road Transport Companies*, IME Newsletter, vol. 7, No 1-2, p. 2-11.

¹⁸ See Attachment 3 for price controls.

¹⁹ 1995 Price Act legalized the tendency of increasing price controls. Its adoption was excused by need for “consumer protection” and government intervention “in times of shortages”. Its impact was that in 1995 the level of controlled prices jumped two and half times. Reform cabinet issued a Decree 269 (July 1997), which intention was to eliminate wholesale and regulated prices of basic consumer commodities - bread, meal, cheese, milk, meat, sugar, eggs, vegetables oil, etc., requiring that all contracts with these goods envisage so called “final” (or retail) price at which they are acquired by the consumer. The share of commodities which prices are regulated by this act was 2,78 % of GDP in 1998. The Decree was implemented with a considerable political noise: strong rhetoric against wholesaling merchants; president’s, ministers of trade and interior, street police, local government etc. visits to open air markets and so on.

Fiscal Environment Before 1998

There are evidences that fiscal rules have been counter productive for a transparent and formal development of the private sector. Predictability of the regulations used to be one the key problems. The major tax laws were changed 66 times during the period 1991-1998, and the respective "implementation rules," 43 times. That is equivalent to an annual average of 8.25 and 5.38 times, respectively. Altogether, amendments (or adoption of new regulations) to tax regulations occurred 16.13 times per year. That makes 1.34 times a month. Since the beginning of the reform, the CM has issued 49 ordinances and instructions to complement tax legislation. Over the period 1996-1998 only, the General Tax Directorate (GTD) with the Ministry of Finance issued 71 interpretation letters. Even after the Parliament announced at the end of 1997 that the new tax laws would be clear and would need no further interpretation, the GTD has issued 14 letters in 1998, and 12 in 1999. This makes long-term decisions impossible, or at least too costly. Three different laws have regulated corporate taxation. Eventual impact of these policies is that costs of compliance with tax legislation have been times higher than costs of non-compliance.²⁰

Taxation of labor is a separate case. Impediments to formal development of the private sectors combined with delayed reforms in pensions and healthcare have maintained high cost of formal employment.

Cost of formal employment

	Average wage in public sector (in BGL ²¹)	Personal income tax due (in BGL)	As percentage of average gross wage	Obligatory social welfare contributions paid by the employee (in BGL)	As percentage of average gross wage	Obligatory social welfare contributions paid by the employer (in BGL)	As percentage of average gross wage	Cost for the employer of 100 BGL net income received by the worker
1991	959	116	12,1%			354,83	37%	155,85
1992	2 047	301	14,7%			757,39	37%	160,62
1993	3 231	445	13,8%			1195,47	37%	158,88
1994	4 960	700	14,1%			2083,20	42%	165,33
1995	7 597	969	12,8%			3190,74	42%	162,76
1996	14392	2639	18,3%	288	2%	6044,64	42%	178,25
1997	141 640	20208	14,3%	4108	2,9%	59488,91	42%	171,43
1998	208135	35746	17,2%	6036	2,9%	84502,81	40,6%	175,91
1999	210 000	31143	14,8%	9450	4,5%	86520,00	41,2%	175,03

Source: IME

The table illustrates the dynamics of total labor costs imposed by the government through the tax and social welfare system. The last column shows the total cost paid by the employer for BGL 100 net income received by the worker. With few exceptions, the cost is constantly rising during the last 9 years. The effective personal income tax burden (for average wage) being relatively stable, the overall increase of labor costs imposed by the government is mainly due to the social welfare system. The policy has been of increasing revenues through increasing tax (contribution) rates. The outcome is a vicious circle of fewer and fewer legally employed workers, and higher and higher rates during the years. Naturally, in order to maintain informal employment, businesses should be able to also collect informal revenues, and thus activities go in the shadow. Employers and employees often come to an

²⁰ See for a detailed discussion: *Latchezar Bogdanov*, Transparency of tax regulations and costs of compliance, *Finansijska Praksa*, Zagreb, 1999, No 4-5, p. 497-509 (in Croatian).

²¹ In old Bulgarian leva

agreement to jointly seek tax-evasion schemes. These constellation of interests supports anti-rule-of-law corporate and employee behavior, erodes public discontent against corruption and motivates a counter-reaction on behalf of the government to intervene at the edge of violating private property, privacy rights in order force businesses to formality.

State Owned Enterprises and the Administration

Since 1995 state owned enterprises (SOE) have a secondary role in GDP, during all transition years private sector was compensating for the decline of the government industries²². But it is obvious that policies towards government enterprises have been key factor in institutional reforms. They still retain over 45% of the assets in the Bulgarian economy. The major tool for “manual” (through direct involvement of the central government officials and/or appointees) control in the real economy is the procurement of “state property rights”. Rules here were established as late as in 1994, by the Council of Ministers’ Decree N7.

Since enacted it has been amended 17 times, mostly in sections dealing with the remuneration of managers and board members. Articles 10 and 11 stipulate that in the SOE’s sole proprietor’s rights are being exercised by the line ministries (those of industry, trade, tourism, agriculture, energy, posts and telecommunications etc.), and by the Council of Ministers (in the case of military industries). In fact, the prime minister and the cabinet are established as sole proprietors of last resort due their control functions over the acts of the line ministers. Line ministers appoint SOE’s managers and board members at their discretion. Members of the central administration are not allowed to sit on the boards of more than two enterprises, although there is no limit for members of parliament. There is no competition requirement or any provision to contract out managerial teams or use venture capitals schemes. There is no prohibition to do so but in reality it has never happened. Required to exercise public interest in SOE’s, line ministers are afraid of being accused for not fulfilling this requirement. All sets of government the country changed during transition have preferred to bring fellow-partisans in thus paying back for political services and loyalty. Decree N7 requires also managers and ministers to close down enterprises when liabilities exceed 50 per cent of the assets. This provision has never been implemented by the administration before 1998. No measures to improve SOE’s performance through remuneration of managers and/or board members have been workable. There were efforts on restructuring SOE’s operation under the general provisions of the Commercial Code. None of the amendments succeeded in solving the major problem: the appointing of executive management with at least an element of competition or venture capitalism, for a designated period of three years. Managers protect their seats in the administration of the respective line-ministry, or on its “list” of people entitled to certain positions. These incentives, however, coincides neither with increased profit nor with the acquisition of managerial knowledge under market conditions. It used to form and forms a constellation of interests, which multiplies the detrimental effects on the economy in general. As a result, loss-making enterprises were not closed. It also led to political pressure for soft bank loans. It blocked privatization. It drained commercial banks. Nevertheless, five governments (two of them interim ones) maintained same system. Currently it is being destroyed by privatization but supplemented via asset distribution to insiders. But even after privatization the government retains between 10 and 33% minority share in virtually every privatized entity. In other words, about 2000 government appointees still sit on enterprise board. This fact supports the presumption that administration could seek other opportunities to retain its involvement in the real economy.

²² See: *In Search for Growth*.

Economic and Political Implications

Legacies and constellations of first transition years have established a pro-corruption political and institutional environment. Though to some extent natural, the inherited sources of trust remained dominant over the new business networks and prevented emergence of formal (institutionalized) sources of trusts that could benefit more agents in their pursuit of new economic opportunities. In fact, in Bulgaria, the extended and formal trust is constantly loosing competition. This is reflected in procrastinated institutional reforms, in non-transparent ways of privatization described above, and in the low volume of foreign investment. However, political consequences are equally important. There is a general feeling that reforms have been unfair, designed to benefit semi-formal interest groups. The majority who found they unjustly loosing from reforms, during most transition years has been expecting a central government subsidy as a compensation for past unfairness, or simply was going informal. New coming political parties find little competitive options but to seek their own clientele or recourse again on politically dependent state owned enterprise. Clientalistic behavior of incumbent governments was somehow excusable for the voters, given there understood that the “newcomers” should purge “old crooks” that had already looted the people. Voters, especially supporters of the “newcomers” or at least those disappointed by the “old-timers”, were most of the time even ready to tolerate some lack transparency.

There is steady public conviction that the phenomenon is widely spread: all regular (since spring 1998) public opinion polls on the issue conducted since 1998 by different agencies indicate on average more then 60% of the Bulgarian citizens consider corruption a key disease of the government and society. As measured by annual Transparency International Corruption Perception Index (TI CPI), Bulgaria falls in the group of the most corrupt countries.²³ Besides the overall progress of economic reforms (the macroeconomic predictability of the business environment, the monetary transparency introduced by the currency board system, the achievements in transparency of economic policy formation under the 3-Year IMF Program of 1998, and the fiscal and government debt information²⁴), it seems there was no impact on the public perception of corruption. People believe it has penetrated the very fabric of the society and eroded the government. Improved fiscal transparency is not perceived as less corruption. Since 1998, public assessment of the phenomenon’s magnitude practically did not change while the general impression is that on institutional level it is becoming more and more present.²⁵

In Bulgaria, the incumbent political parties in all the sets of government since 1989 sought opportunities to benefit closer or wider circles of political functionaries. This behavior used to create and still creates an environment in which both higher and lower level public servants, including managers of state owned enterprise, feel protected not only when channeling funds to the vaults of the fellow political party but for private gain as well.

The understanding of the incumbency as a reward for past political services has not been especially surveyed. The division line between partisan and private interest have not been and could not been properly established and monitored. There was no political will to promote either superior and/or independent (or parliamentary) agency control mechanisms or government-on-the-sunshine procedures (access to government information, to public files and registries, to regulations in pipeline, availability of public office records, etc.).

²³ TI CPI includes Bulgaria since 1998; it is not possible to track its performance over a longer period of time.

²⁴ See IMF Mission report on Transparency of Economic Practices in Bulgaria, published on the website of the government of Bulgaria (www.bulgaria.government.bg)

²⁵ See: *Corruption Assessment Report 1999*, Sofia, Coalition 2000, 1999, p. 5,8 (Internet version: www.online.bg/coalition2000).

Reflecting the current Bulgarian constellation of forms of corruption it is important also to mention that the political corruption has been the systemic backbone of what is usually distinguished as high and low level abuse of public office for private gain. It necessitated an approach to public life, which on the side of the side of the citizenry may be characterized as rational ignorance. In other words, the problem has not become the one of corruption *per se* but rather one of not knowing what to do with it.

Krassen Stanchev, Ph.D.,

Executive Director, Institute for Market Economics

Tel./fax: (+359 2) 944 71 19, 943 36 48

82A Dondukov Blvd., 1504 Sofia, Bulgaria;

E-mail address: stanchev@ime.bg, ime@omega.bg

Website: www.ime-bg.org

Attachment 1. Sequence of Bulgarian Government Changes: 1989-1999

MONTH/ YEAR	EVENT	PRESIDENT	CABINET (PM)
11/89	BCP Coup	Mladenov (BCP, BSP) 11/89-7/90	Atanasov (BCP) 2/87-2/90
6/90	Election of the Constituent Assembly – BSP wins		Lukanov (BCP/BSP) 2-10/90
8/90	Parliament appoints new President ²⁶	Zhelev (UDF) 8/90-1/92	
12/90	Coalition Government		Popov (unaffiliated) 12/90-10/91
10/91	General & municipal elections - No clear majority		Dimitrov (UDF minority government) 11/91-10/92
1/92	Presidential elections	Zhelev (UDF) 1/92-01/97	
12/92-09/94	Government of Technocrats		Berov (unaffiliated)
9/94-01/95	Caretaker cabinet		Indjova (unaffiliated)
12/94	General elections – BSP wins		Videnov (BSP) 1/95-12/96
10-11/96	Presidential elections	Stoyanov (UDF) 1/97-present	
2/97	Caretaker cabinet		Sofianski (UDF) 2/97-05/97
4/97-present	General elections – UDF wins		Kostov (UDF) 5/97-present

Legend

- Socialist
- Democrat
- Unaffiliated Prime Minister + socialists represented in the cabinet

Abbreviations

BCP – Bulgarian Communist Party
 BSP – Bulgarian Socialist Party (renamed BCP)
 UDF - Union of Democratic Forces/United Democratic Forces

Attachment 2: Examples Low-level corruption

As mentioned, public at large is convinced corruption is widespread. Regular Coalition 2000 polling on corruption perception indicated an overall increase of believed corruption in practically all government agencies.

Corruption in government agencies

Agency	April '99	September '99
Customs	8.78	9.1

²⁶ Note that, following the 1991 Constitution; the people of Bulgaria directly elect the President.

Tax authorities	7.1	7.98
Courts	7.62	7.88
Privatization Agency	7.46	7.86
Police	7.16	7.54
Sector ministries	6.94	7.4
Foreign Aid Agency	7.02	7.4
District Authorities	6.9	7.32
Municipal administration	6.64	7.24
Parliament	6.78	7.16
Council of Ministers	6.58	7.12
Committee of Energy	6.4	6.84
Post and Telecommunications	5.86	6.42
Competition Protection Commission	6.14	6.4
Securities and Stock Exchange Commission	6.24	6.28
Chamber of Accounts	5.74	5.86
Central Bank	5.34	5.32
Army	4.88	5.06
Statistics Institute	4.8	5.54
Presidency	4.46	4.5

Source: Coalition 2000 Corruption Measurement System (10 scores mean highest perceived level of corruption).

It is difficult to judge to what extent the above rates reflect the reality, and to what extent they express public beliefs on corrupted officials. Foreign Aid Agency, for example, was assessed rather corrupt. But at the time of the surveys it had virtually no activity for years and the assessment was given “in principle”. National Statistics Institute (NSI) is on the bottom of the ranking because few people have reason to deal with it.²⁷ Committees of Energy and Post and Telecommunications are principals of electricity and telephone monopolies which engineers have public but unofficial price lists for services presumably payable by the consumers through the formal fees but in fact delivered as a precondition to become a consumer against cash (without a receipt). To get a telephone line the average “informal” price in a Bulgarian big city equals 150% of the average monthly salary (the average queuing time is five years). To register an electricity meter this price is 75% the average monthly salary, payable to the engineers. These widely known facts do not seem to hamper the image of the responsible government agencies. In contrast, customs deserved blame by the general public, which more rarely encounters customs officials, at least in comparison with electricity and telephone government monopolies. (The explanation seems to be that the press covered very often how families of custom officers prospered). Also there are important omissions. The image of the finance ministry has not been checked at all, although it is the ministry responsible for the two most corrupt (in the eyes of the citizenry) administrations.

It is possible that part of the custom corruption has its roots in a complex constellation of different factors: impact of embargoes, imperfect regulations, tradition and habits of the time

²⁷ Procedure to obtain data from NSI is to send a letter to the director, which is to be answered within a month. Faster service is available through contracting NSI employees, or via companies specialized on disclosing data from company reports prohibited by law for public access. NSI also rents office space to an ex-government owned *Informatzionno Obsluzhvane* (Information Service) JSC, in 1999 privatised by a MEBO which has an exclusive contract with the Company Registry, Ministry of Justice, Ministry of Finance and NSI based Company Statistics (BULSTAT) which gives it the exclusive right to provide information from the company registry for a fee on an average 30% higher than fees of the named institutions; information is delivered faster than by the institutions themselves.

of central planning, competence of border crossing and custom official, fairness of taxes, reasonableness of procedures, etc.

A 1996 comparative survey of international motor carriers with offices in Bulgaria, conducted by IME and the American University in Bulgaria (AUBG) grasped the following picture.

Border Crossing Conditions (Bulgaria, Macedonia and Romania)

ITEM	BULGARIA	MACEDONIA, FYR	ROMANIA
Overall quality of facilities (0-to-10)	3.2	4.5	2.3
Security from theft (0-to-10)	1.8	4.5	1.9
Ease and reasonableness of processing (0-to-10)	3.7	3.8	2.1
Honesty and competence of border officials (0-to-10)	2.9	3.5	2.4
Percent of time a bribe or gift is demanded by officials	74%	54%	73%
Fairness of taxes and other charges (0-to-10)	4.6	2.5	1.8
Clarity and fairness of regulations (0-to-10)	3.9	6.0	2.4

Source: IME, AUBG.

The same survey also indicated a very low carriers perception of the honesty and competence of the traffic police 2.7 scores (out of ten possible for the best competence, 3.7 for Macedonia and 1.9 for Romania); percent of times when stopped within the country in which a bribe or gift was demanded by traffic officials was estimated as high as 56% (in Macedonia 47%, Romania - 79%) while clarity and fairness of regulations was praised relatively well (5 scores, against 3.5 for Macedonia and 3 for Romania).

Operating in the formal sector of the economy is a headache, often caused by local authorities or by duplication of documents and annual renewability of licenses and permits. A recent IME survey on Licensing Requirements in Retail and Wholesale Trade and Commercial Road Transport Companies²⁸ found that retail and wholesale trade firms have to present 19 documents that were required by the respective municipality to grant the license. Some of them are documents related to the general company registration (such as documents for court registration, tax registration, social security registration, etc.) The rest are documents to be issued by another government institution, which itself has separate procedures and requirements for granting the document. Typical examples are hygiene and sanitary permits, and fire safety certificates. Obtaining each of them involves both compliance with standards and requirements set in laws and regulations as well as presenting new documents again. The process is multi-stage and often senseless. E.g. getting a sanitary permit to a retailer requires obtaining health certificates for all the employees. Interviewed companies mention 17 institutions which issue different permits, among them government owned utilities monopolies, Water Supply and Sewerage (WSS) and National Electrical Company (NEC), since documents issued by them are also required for a permit. For all three surveyed sectors the average time firms spent on licensing is 7.5 man weeks with average 14 visits to the government bodies and monopolies.

The objective of these surveys was not to measure corruption, but the results suggest that incentive to attempt to speed up the process of dealing with the government or to avoid registration and reporting are numerous, thus sustaining a pro-corruption environment.

²⁸ The report on the survey is pasted IME website (www.ime-bg.org), or *IME Newsletter*, vol. 6, 2000, No. 1-2.

Attachment 3. Share of controlled prices as a percent of consumer basket

Year	Share
1991	14.0%
1992	13.4%
1993	16.5%
1994	18.9%
1995	49.0%
1996	52.4%
1997	45.0%
1998	15.8%

Source: NSI, IME calculations